Succession planning in closely held const. businesses

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Leadership Plan: The leadership plan involves more than just the existing leader and successor, but all the other key constituents the CEO has contact with regularly. The successor should "shadow" the existing leader to become familiar with the business and how the CEO interacts and runs things. Changes to how a business conducts day-to-day operations should be a well thought out idea that includes all members of management.

Career Planning: The plan should also include the career paths of key project people and employees and how they fit into the succession and development plan. This is absolutely key so the firm has a clear plan for its key employees and so they see their continued place in the organization. Also, the management of the company needs to understand these aspects so it can be effectively communicated to the employees and related business community.

Continuous Improvement: The plan needs to be updated annually and should be "tweaked" as the succession process evolves. For example, the existing CEO may come to find that he has a particular management function that could be given to someone else in the organization because they are better suited to handle it.

At this point in the process, separation between the exiting CEO and the new CEO is important. The two leaders need to spend time away from one another and respect each other's evolving roles. The exiting CEO needs to grow comfortable not being in charge and the new CEO needs to begin to get used to doing things on his own.

There can be many pitfalls along the way as this process evolves. One of the most common is inadequate financial security for the retiring owner. Essentially, the combination of the buyout money and retirement savings is often not enough to maintain the accustomed lifestyle. Another potential problem can develop if the wrong successor was selected or a conflict develops between the owner and the successor.

In terms of the actual mechanics of the transfer of ownership, the organization's top advisors should be consulted and the following options should be examined individually and in combination: stock redemption agreements; stock bonus plans; phantom stock plans; incentive stock options; and compensation plans; employee stock ownership plans (ESOPs); and parallel company/spin-offs.

The owner and successor need to approach the ownership transfer as financial partners. As the existing equity is drawn out by the old owners it needs to be replenished with new equity. This is usually a combination of future earnings retained by the business and periodic capital contributions by the next generation of equity owners. The mix is determined by the transfer options selected and here the company's accountant and attorney will play a key role. Without this carefully planned financial balance, the surety and bank may cut back overall available credit, thus potentially inhibiting growth.

In cases where the ownership will stay with the family, the outside professionals need to have

extensive estate planning experience. Poorly structured transfer options could cost millions in estate taxes later, especially if the new leader is successful and grows the company and makes it even more profitable. The right balance of gifting and outright sales to the next generation can be very complex, especially if there are outside family members or in-laws obtaining ownership.

The transfer options need to be structured in a way that the old owners maintain financial control until they are satisfied that giving up the ownership and control has been earned and warranted.

These are perfect situations for incentive and phantom stock ownership plans in which the new owners vest in their ownership rights and benefits but can be canceled or bought out at the company's discretion should they find the chosen successors are not a good fit or worse, a family member gets divorced from a key employee involved in the buyout.

As a professional who has witnessed many succession planning failures and successes, I know that the rate of success goes up dramatically when the plan is well thought out and the participants involved make honest assessments of what made the business successful and what it will take for the next generation to achieve their goals. Those assessments are often eye-opening experiences to the old owner, but as long as the experience is embraced by everyone and top priority goes to the best interest of the business, it can be a productive, successful process and all parties involved will benefit.

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